

15 July 1957

MEMORANDUM FOR: Deputy Director/Intelligence

SUBJECT: U.S. Economic Defense Policy Proposal Submitted to NSC
by the Secretary of Defense, dated 19 June 1957

1. The general tenor of the defense of this proposal is instrumental in shaping any reaction to the proposal itself. If it may be agreed, as it is argued, that the trade control program of the U.S. and the COMSEC community has been a major force impeding the development of the military strength of the Sino-Soviet Bloc, then the proposals advanced would seem a reasonable course of action for the U.S. to follow. However, it is our view that the Defense arguments for the effectiveness of the control structure in limiting Soviet military strength have been exaggerated. In spite of the application of controls, the Sino-Soviet Bloc has been able to build a powerful military force capable of wreaking mass destruction with the most advanced weapons of modern warfare and capable of providing a formidable defense against such an attack. Bloc military production facilities have been characterized in National Intelligence Estimates as producing at considerably less than capacity levels. Thus, it seems incongruous to learn that the reduction of certain trade controls (i.e., the International Lists, Atomic Energy, and Munitions Controls) poses an "increasing threat to our national and collective security by virtue of its direct contribution to Bloc military build-up."

2. Trade controls have exercised certain limited restraints on the rate of economic growth and on the general development of basic civilian production which may in time of war be brought to bear on military production. These restraints have been limited and they have been localized. Their impact has not been so much to restrain the growth of military strength as it has been to increase the cost of obtaining this strength and reduce the flow of certain goods to the civilian economy. The effect is much the same as obtained under a system of protective tariffs instituted to develop strategic industry. It is reasonable to believe that the Bloc would have purchased only a small percentage of its requirement had such goods been normally available in Western markets. Certain controls (those on munitions items, atomic energy materials, and certain materials and equipment directly used in the production of military end-items) will be supported universally and may be expected to be imposed in any situation on a potential enemy regardless of the restraint to the enemy's military build-up.

3. The Defense proposal makes the general point that the Sino-Soviet Bloc uses trade as a political device or, to put it another way, as a weapon of economic warfare. We concur in this judgment. The JCS is not proposing that the U.S. use trade as a device of political penetration but rather as a weapon to impede Bloc economic development. We must point out, however, that the terms of reference of the COCOM organization specifically and categorically deny the use of that structure as an instrument of economic warfare. This organization does not deny that trade may be used as an effective, albeit limited, weapon in the cold war. We have frequently proposed criteria for trade control (the relative cost criterion) we thought more effective than the present system of trade controls only to be informed that the proposals were "difficult to understand and, besides, basically a program of economic warfare." The U.S. may propose a system of controls such as are implicit in the Defense proposal in COCOM-CHINCOM, but we must be prepared to defend these proposals against the rules of that body and to persuade the participating countries in a free, international forum that this course of action is so attractive and effective that it would be worth abandonment of its rules. Officers of this office who have followed this question closely and who have participated in COCOM-CHINCOM think that the case might be difficult to prove and, even were the case established, believe that there would be little inclination on the part of the membership to embrace such a program.

4. Specific comment directed to arguments advanced in the Defense proposal are set out below, addressed to referenced paragraphs:

Para 1

We agree that CHINCOM gave little security consideration to the U.S. proposals or other proposals for reduction in China trade controls, operating on the accurate assumption that there were rather few items on the list of security significance. One or two years ago careful consideration would have been given the security issue, albeit for political reasons. Although there was a unanimous expression of adherence to the COCOM control structure and its control lists voiced at the meetings, we think that the UK may be preparing for some additional rationalization of the controls lists. This rationalization may well come in the form of proposed reductions of controls lists although proposals we've heard rumored are more toward consolidation of the lists toward a single embargo list.

- Para 2 a (2) There are several completely agreed intelligence documents (including NIE's) all of which indicate that Communist China has not engaged in the maximum level of trade it could support with the Free World. It has been universally recognized that China, in retaliation for Japan's participation in CHINCOM, has refused to ship iron ore and coal to Japan which could have been produced with only the addition of labor which is now unemployed or at best underemployed.
- Para 2 a (3) We agree in general with the specific conclusions although we expect some increase in the value of trade and would caution that the pattern changes would tend to be compensating. There will certainly be an increase in the purchase of hitherto embargoed items from the West by definition. We do not foresee any greater emphasis on the total import (from the Bloc and West) of items hitherto embargoed. There may, indeed, be a decrease in imports of embargoed goods, all suppliers considered. China has been able to secure such items in the past from Bloc trading partners either out of their domestic production or through transshipment (the latter at a slightly higher cost than would have prevailed on open market purchases).
- Para 2 a (4) It is never clear what the JCS means by "strategic commodities"; but, if they have meant the items recently decontrolled, all of these goods have been available to Communist China if they chose to obtain them. Thus, the argument seems to be devoid of substance.
- Para 2 a (5) There is no evidence that China trade controls limited the Chinese military build-up other than to make it more expensive and a somewhat greater drain on the civilian economy. There will be little relief of stress or strain either in China or elsewhere in the Bloc. Some modest reduction of transport cost will be noticed, probably not enough of a reduction to compensate for uneven growth of transport and industrial capacity.
- Para 2 a (6) Both the preceding paragraph and this one appear to contradict the statement in 2 a (2) that there would be no increase in the value of trade. We agree with the conclusions in this paragraph and disagree with those in 2 a (2). We would have preferred to recognize that there will be a mutual heightened sensitivity.

Para 2 a (7) Use of long-term loans to finance trade may occur but we would estimate that the probability of such loans would be zero unless there should be a significant change in China's political control structure. The United States was the first nation in COCOM (the recent loan to Poland) to provide long-term credits to a nation subject to COCOM action since the inception of the multilateral trade control structure.

Para 2 b (1) The only meaningful gains that might accrue to the Soviets would arise from the import of advanced technical design directly useful to the military effort. There is no indication that such a proposal will be made by any COCOM member. Imports of this nature would be as likely to lead to increased outlays on R&D as to a reduction. The statement of "obvious needs" belies U.S. estimate of the situation in the military and item production and the question of economic warfare will be raised again in the matter of industrial development.

Para 2 b (2) We would agree in general.

Para 3 a The problem of overstatement is perhaps most acute at this point. Elimination of all IL I and II controls would add a negligible capability for military and items to an enormous existing capability. (Para 102 ff of NIE 11-3-55)

Para 3 b The use or threat of use of the Battle Act and other remedies outlined has been considered on several occasions since the trade control structure was inaugurated in 1948, and on each occasion such action has been denied. It would, nevertheless, seem important to continue to weigh the balance of potential loss of allied strength against the potential further erosion of the trade control structure including the item by item composition of these controls.

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